

June 14, 1989

LETTER 1019

Please turn to page 6 for the statistics.

THE MARKET: Big Picture: Note: it's important that my subscribers understand the following discussion of the price movement. Here goes: Up until recently, the stock market remained almost perfectly "in gear" on the upside, with each rally taking the D-J Averages above previous near-term peaks and each decline halting above previous near-term lows. But two significant discrepancies now exist, and it will be extremely important to see how these technical problems are resolved.

Here's the first technical problem (noticed by very few, by the way): On April 17 the D-J Transportation Average rallied above its 1987 bull market peak, to close at a new all-time high. The Industrials failed to confirm. It's been almost two months since the April 17 Transport peak, and the Industrials still have not rallied to a new high of their own (above their 1987 bull market high). To confirm, the Dow would have to better the 2722.42 level.

The longer the elapsed time without an Industrial confirmation, the less appetizing the situation becomes. Yes, I'm aware that "a new all-time Dow high" has been all but guaranteed by most of today's experts. But the confirmation will have to come from the market, not from the promises of the experts. I feel the Dow non-confirmation has taken on added importance in view of the extreme bullishness which now prevails in the marketplace.

Second problem: By any reckoning, the Transportation Average has been the stronger of the two Averages in that the Transports advanced to new record highs alone (the Transports hit their all-time record closing high of 1165.59 on May 26). The market subsequently sold off, then rallied again. On the latest advance the Dow pushed to a new post-crash recovery high (not an all-time high) of 2517.83 on June 2. But this time it was the Transports that failed to confirm (to confirm Transports would have had to close above 1165.59). Thus, we have a situation where first the Dow refused to confirm the strength in the Transports, and more recently the Transports failed to confirm a recovery high in the Dow.

This constitutes a "double non-confirmation" -- or a minor non-confirmation coming within the area of a primary non-confirmation. Another way of looking at it is that first the Dow turned weak (it failed to confirm the stronger Transports) and then the Transports turned weak (they failed to confirm the June 2 recovery high in the Dow). These double non-confirmations are very rare, and more often than not they spell trouble.

Comment: I note that many advisors and gurus are hanging on each new economic statistic (i.e. Producer Price Index, auto sales, unemployment level, etc.) expecting it to provide them with hints about the trend of the market. Don't fall into that trap.

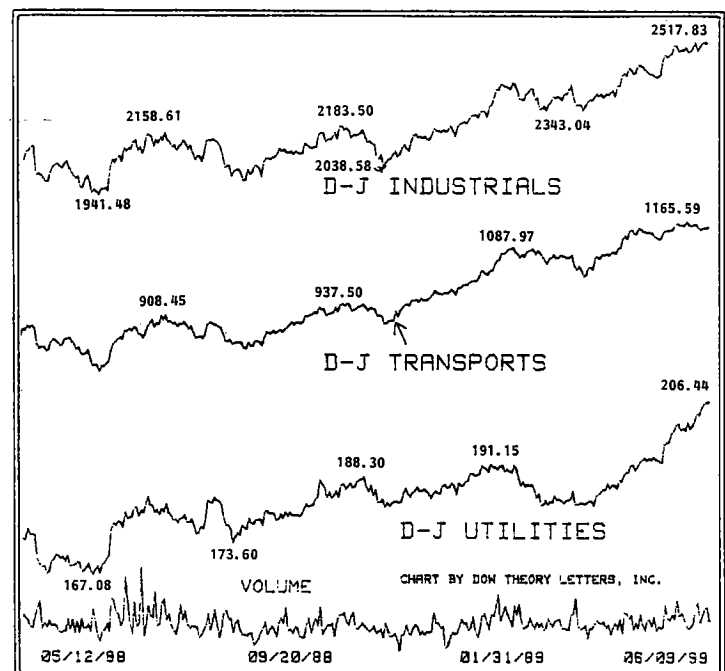
Let me put it this way: If the primary trend of the market is down, the story is already written in stone. And the story is that the Dow will top out without ever going above its 1987 high -- and in due time the bear market will resume. But if a new bull market did start from the October 1987 lows, then it's guaranteed that in due time the Dow will confirm the Transports by rallying above the 1987 high. As subscribers know, I'm betting that a bear market began in August 1987, in which case the Dow is not fated to better the old high -- **REGARDLESS OF ANY AND ALL GOOD NEWS.**

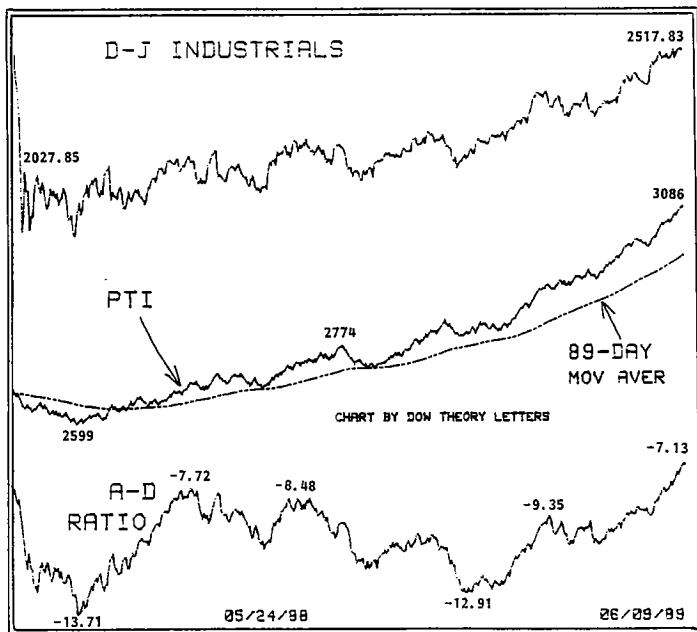
Primary Trend Index (PTI): All during 1988 and '89 my Primary Trend Index (PTI) has proved invaluable. The PTI has led all the way in that it has continued to rally to new highs. The chart on page 2 tells the story. Remember, the PTI doesn't care about values or yields or cycles or sentiment -- it only cares about the underlying market technicals. Up to this writing, the PTI has been a tiger on the upside. Somewhere ahead the PTI will turn down on a trend basis, break below its moving average, and stay there. That will constitute a major sell signal. Of course, it hasn't happened yet.

Values: The current yield on the Dow is a slim 3.51%. The yield on the Transportation Average is an almost non-existent 1.53%. The percentage of undervalued blue-chip stocks has just dropped to 17%. This 17% is the exact percentage seen in January 1973, at which point a major bear market started. From another standpoint, the S&P 500 Average is now selling at 29.3 times dividends, which is historically a "high risk" level. Thus, from a valuation standpoint, the stock market is on thin ice.

COMMENTS: With yields on stocks low, Wall Street is particularly sensitive to money rates. On June 2-5 many banks cut their prime rate. The markets took the cut in the prime as the signal for generally easier money (traders felt that they were again seeing a situation where the market was telling the Fed what to do). On the prime cut, the bond market rallied strongly. Obviously, the bond market believes that it's only a matter of time before the Fed moves toward a position of ease.

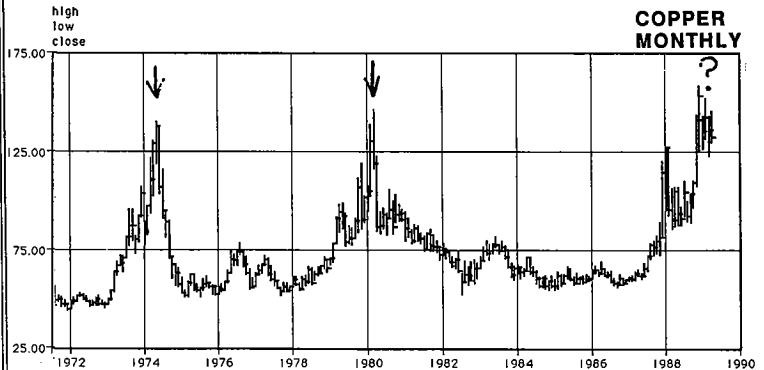
But the Fed has a problem. If it stands pat on rates the dollar might continue strong. However, a strong dollar hurts US exports, which in turn hurts the US trade balance. On the other hand, if the Fed lowers rates too far, such action would spur inflation. So the Fed took the middle ground; it lowered the Fed Funds a bit -- 1/4% to 9.5%.





Here are a few very important charts. The first shows the CRB Commodities Futures Index breaking below its major support at 232. On the face of it, that should be deflationary. But the other chart shows the year-to-year change in the Consumer Price Index. Here we see that an inflationary rise is underway. To add to the mystery, on June 9 it was announced that the Producer Price Index was up 0.9%, an annualized gain of over 11%. The PPI tends to lead the Consumer Price Index.

\$360 level. Copper (often considered a bellwether of the economy) traced out a major spike-top and has tumbled. Copper spike-rallies appeared in 1975 and again in 1979-80. The aftermath of each spike was a collapse in copper prices accompanied by recession in the economy. Lumber has been in a downtrend since last February. The weak lumber prices are undoubtedly saying something about the forthcoming picture for construction (see long-term copper chart, courtesy of *Dunn & Hargitt*).



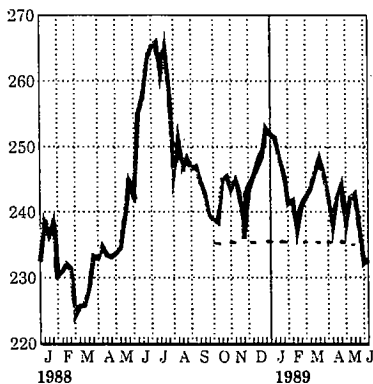
Despite massive Fed and world central bank intervention, the dollar continues very strong. I doubt if anyone knows the exact reason for the dollar's strength. Whatever the reason, the dollar is certainly climbing powerfully against the major world currencies.

In truth, there are some fundamental reasons for the dollar's rise. First, interest rates in the US have been highly attractive compared to the rates in most of the other developed nations (with the exceptions of Britain where the bank rate has risen to 14%). High interest rates attract money. Second, world unrest (chaos in China, panic in Hong Kong, rampant inflation in Brazil and Argentina, political troubles in Japan) causes much wealth to move toward the stability and safety of the US.

But to my mind, the most compelling reason for dollar strength is simply that there is a scarcity of dollars. While the money supply of Japan and our European trading partners has been booming, the growth rate of the US money supply has been slumping dramatically. This chart (courtesy of Ed Hyman of *C.J. Lawrence*) shows the picture. Note that this chart goes back to the 1970s. Of course, a third reason for the dollar's rise is the purchasing power parity. I saw that in London. The fact is that the dollar buys an awful lot compared to what most other major currencies buy (I said in the last Letter that I felt the pound sterling was 30% overvalued compared with dollars).

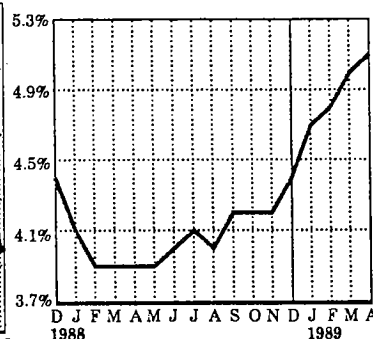
Futures Prices

CRB index of prices of 21 commodities traded on futures markets: 1967=100



Inflation Is Heating Up...

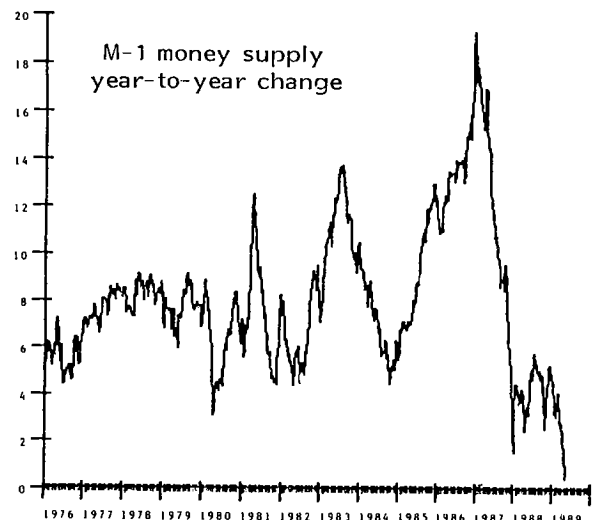
Year-to-year change in Consumer Price Index; percent



Has the economy gone crazy? Can inflation heat up with money supply growth collapsing and the CRB dropping? I'm sure that's what the Fed is wondering. Personally, I think the rise in inflation could be a function of the global economy plus the heavy influx of foreign money. After all, two weeks ago a Chippendale desk was auctioned off in NYC for an unbelievable \$12.1 million. On the West Coast, real estate is up 25% for the most recent twelve months, and movie theaters on both coasts are starting to charge \$7 per show (you can hardly call that deflation, can you Mr. Greenspan?)

BUT WHAT ARE THE MARKETS TELLING US? The Producer Price Index and the Consumer Price Index and the inflation figures tell us what happened yesterday -- they're history. The markets deal with investors' perceptions of what lies ahead. All right, what's happening in the markets? The widely-followed CRB Commodity Futures Index (21 commodities) has broken down badly. Gold dropped \$16 on June 9 to close below the important

M-1 money supply year-to-year change



Meanwhile, the bond market has been extremely strong while gold has been weak. This has sent the gold/bond ratio sharply higher. A surging gold/bond ratio is a classic signal for deflation.

Normally (is anything normal these days?) all of the above "should" spell recession with a capital R. But currently about half

the economists are talking about "the good times lasting at least into 1990 or even beyond." The other half are repeating the phrase "soft landing" so often you'd think they were a gang of mattress salesmen. Of course, history tells us that since 1900 there's never been a soft landing following an economic boom.

OVERALL: As I look at the overall picture, the overwhelming impression is that confusion reigns. On the plus side, my PTI is still acting well -- it's in the vicinity of its all-time high. But the D-J Averages are beginning to show signs of strain. The bond market continues on the upside, and despite inflation statistics from the government, the commodity markets and gold are saying deflation. The growth rate of the money supply has collapsed, and collapsing money supply growth has always been associated with weak stock markets and recession in the economy.

Alan Greenspan is said to want zero inflation, and the way the commodities, gold and the money supply are acting, he may get it. But here's the catch -- I don't think this highly-leveraged, junk bond-laden economy can stand zero inflation or actual deflation. There's just too much debt out there, and it's debt that has been nursed and spoon-fed by inflation and easy money and government bail-outs.

Let the money supply continue to decline, let inflation drop to zero or turn into net deflation, let a recession hit, and I think we'll see an avalanche of bankruptcies. The fact is that our junk bond corporations and debt-logged companies have had a picnic for the past seven years. They haven't been tested through anything like hard times. That's the problem, and that's probably the thought that keeps Alan Greenspan up at night.

There's no question about it, the Fed's under pressure. If the declining money supply does set off a severe recession, you can bet that all hell would break loose in Washington. Congress would call for a restructuring of the Fed or even a takeover of the Fed by the Treasury. Remember, the Fed (like every other government agency) wants to perpetuate itself. But that's another story.

Last week Merrill Lynch (in full-page ads in newspapers across the nation) stated, "Merrill Lynch Strongly Recommends Shifting Funds From Cash to Selected Bonds and Stocks." The ad advised a position of 55% bonds and 45% stocks. On June 7 Shearson Lehman joined Merrill with a full-page ad in the *WSJ* stating that "The Risk Today Is Being Out of the Market Rather Than In it." Shearson and Merrill could well be right, but I've never been able to follow brokerage house ads and make money.

INVESTMENT POSITION: Confession: In 40 years of investing in the markets the only big profits I've ever made have been from buying great values (i.e., stock or bonds with high returns) during depressed periods at or near bear market bottoms. I've never been able (and believe me I've tried) to make big profits from trading.



A major reason why I haven't been able to make big profits from trading is that I haven't been gutsy enough to take major trading positions. To make big money, one has to be able to assume large positions, positions that represent such good value that one can sit with those positions and ignore daily fluctuations. For instance, when I was buying stocks during 1982 and '84, I was buying shares with very high yields, and I didn't care what fluctuations hit the market -- I was getting paid big for waiting. The same thing applied when I was buying bonds in 1982 and again during 1984 and thereafter.

Profits are profits, regardless of where they come from. Of late, the bond market has been surging wildly, and Dow Theory Letters subscribers must be feeling good, if not ecstatic (I've been recommending bonds for years). California general obligation

bonds that were yielding 9 or 10% when I bought them have now dropped to yields below 6.85%. The profits in those bonds have been huge, and I have begun to take some of those profits. Honestly, I don't know whether I'm right or wrong, but at 6.8% I feel that my bonds are no longer great values (particularly when I can put money in muni-cash funds at around 6.0%).

At any rate, I'm not greedy. I have very large profits in most of my bonds, bonds I bought when nobody wanted them, and I'm willing to cash some of them in now. How does the bond market look to me? It still looks good. The only thing wrong is that everybody else thinks bonds look good. Where were they two or three or five years ago when bonds were on the bargain counter, and I was recommending them in every Letter? They hated bonds then.

As for the stock market, you don't have to be a genius to know that it's been strong. As I pointed out on page 1, there are only two flaws in the current picture. The first is the non-confirmations. The second is the over-valuation. Charles Dow placed great emphasis on values, on buying stocks when they are great values. Stocks are not great values at today's prices. The best reason for buying stocks today is simply that they have been going up.

If the Dow betters 2722.42 I will take the bear out of the box and replace him with a bull. Despite the climbing PTI, the averages have not wiped out their technical bearish verdict of October 15, 1987. Time alone will tell us whether we've been watching the formation of a near-double top in the market -- or whether the primary bull trend is still in force.

SNYDER (Former editor of *International Moneyline*): Here's a thought-provoking letter just received from Julian Snyder via FAX out of St. Moritz, Switzerland: "Dear Dick, Whatever else one may think of the present situation, it is clear that we are currently in a period of debt liquidation similar to that of the 1930s. The total debt figures are comparable with 1929, including Third World countries. Yet we don't have a depression. Why not?"

"The answer is that financial unmentionable -- fiat money. Central banks can create credit and paper money without gold or any tangible behind it, which some smart people have been saying for years would lead to an eventual financial collapse. Yet it doesn't seem to be happening. Why not? The answer seems to be that the world is becoming comfortable with fiat money, and the idea that you can print your way out of a crisis, or bail out the bankrupts, or both.

"During a broadly contractive period, or a period of debt liquidation (as the 1980s have clearly been) it is far easier to create money without drastic consequences. Thus the financial cookie jar that is never empty seems to become a reality. There is no clearer demonstration of this than in the deficit of the US trade balance. In previous eras, such a thing would lead to a run on gold in the deficit country and a contraction of the money supply, which would set off an inevitable recession or depression. But the deficits have been financed by offshore dollars held by the creditor nations -- Germany and Japan. The stock market crash of 1987 may have been a kind of watershed in the seeming triumph of fiat money (we are now in the longest period, following a crash, in history, without a post-crash recession). Some people are beginning to think a recession will never happen.

"What do I think? I would not be at all surprised to see Prechter's original projection of Dow 3600 come true. But will we ever see a depression? You bet. It'll happen, as always, at around the time everyone, including the central bankers, is completely convinced that it can never happen again."

Russell comment: Julian obviously sees wide acceptance of fiat (paper) money as the magic that has allowed the US to continue on its spendthrift ways. I agree. I also see a wide acceptance of "a little inflation," inflation of about 4% to 6%. Put the two together and what do you have? You have America's debt-ridden, inflationary economy. Will these new attitudes result in an avoidance of

recession or depression? Don't bet on it. But they do make for ever-more speculative financial edifices.

I might add that the Fed obviously notes the acceptance of 4% to 6% inflation. After all, that's what we have today, and I don't hear any screaming. Furthermore, the wealth of the average American lies in the value of his home. The 4% to 6% inflation rate acts to prod the prices of homes ever higher. And, of course, that's something that warms the heart of the typical citizen. As I said, I don't hear any screaming about inflation today (in contrast, back in 1970 when inflation hit 5%, Nixon slapped on price controls). Everything, they say, is a matter of timing. What was intolerable yesterday is taken for granted today.

WEDDING: I'll admit it -- I've never been to a Hollywood wedding before, so it certainly was an experience to go to one. The bride was my own daughter, Betsy, who was married on May 27 to Vincent Van Patten (son of Pat and Dick Van Patten). The Van Pattens are a veteran Hollywood family, and the wedding proved quite an experience (at least to me). It was a big wedding (250 people) with a rock band, loads of great low calorie food, a stunning array of beautiful ladies (many were Betsy's actress friends), and a slew of the Van Pattens' friends (they seem to know most of the people in tinsel-town).

At the wedding were Hugh Heffner and his bride-to-be; my former father-in-law, Max Lerner; Alan Alda; Connie Stevens; Jack Carter; Dom DeLuise; Don Adams; Carl Reiner; Mel Brooks and his wife, Anne Bancroft; Lloyd Bridges; Wayne Gretsky and Janet Jones; Valerie Perrine; Dr. Toni Grant; Joanna Pacula, and on and on.



More pictures of these two characters in the current (June 19) issue of People magazine -- page 80.

Here's Betsy and Vincent, minutes after their marriage ceremony. Vince is shaky but still smiling.

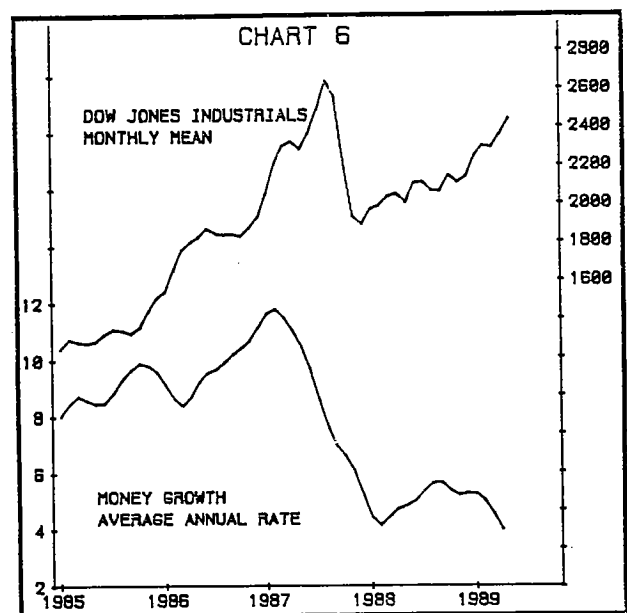
My 11-year-old son, Ryan, spent much of the night talking to Mel Brooks (they seemed fascinated with each other). My 8-year-old daughter, Lauren, danced (rather rocked) the entire night away. Daughter Betsy looked beautiful, and the groom looked spectacular. My oldest daughter, Daria, was there with her new 3-month-old son, Nicholas. (Gad, I'm a grandpa. I look in the

mirror, but I still can't believe it.) The party lasted from noon until 11:30PM, so you know it was a winner.



Ryan and Dom DeLuise. Does that DeLuise have a smile or what!

MONEY and STOCKS: I've included many comments about the money growth in these Letters. Here's another one -- this from veteran market observer Bill Bretz (*Juncture Recognition*, Box 1209, Pompano Beach, FL 33061). The chart is also Bill's.



Bill writes, "Although M1, which only includes checking deposits and currency, has turned negative a number of times, there is no recent history in which the broad money supply has turned negative on a 3-month average annual rate. It did so in 1920-21, 1929-33, 1937-38, and 1948-49, all of which were periods of severe stress for stock prices. It also dropped close to the zero mark in 1960 and 1970, both of which were bear markets. The chart is a composite of all three categories (M1, M2, M3) and therefore it reacts slightly faster than would M3 alone. The thing to keep in mind is that, going right back through the twenties, it is fairly rare for any extended drop in money growth to leave the stock market unscathed. This is especially true when the market is technically overbought, as it is now."

I thought Bill's comments and his chart represent a fascinating commentary on the current situation. In view of the above, one has to ask, "What's been holding this market up?" The answer may be (1) an influx of foreign money, (2) the excitement of corporate takeovers, (3) manipulation via program trading. I might add, however, that foreigners have been notoriously poor at market

timing. Historically, you can almost match heavy foreign buying of stocks on the NYSE with market tops. Conclusion: This is a time to be very careful.

NOTES & QUOTES: The government may claim that inflation is under control at around 5%, but home prices keep advancing, although admittedly there are areas of weakness. At any rate, the average price of both new and used homes in the US jumped a shocking 11.4% during the first three months of 1989. The most expensive average price in the nation was in (would you believe) Minneapolis-St. Paul with average prices of \$215,000. Second was San Francisco at \$208,000. Lowest price area was Louisville, Ky. at \$79,700. Biggest increase was Milwaukee up 37.5% over last year. Columbus, Ohio was up 32.4% and Chicago up 32.2% (what's happening in the Midwest?).

There's a new economic "Tiger" coming on the scene. We have the Four Tigers: South Korea, Taiwan, Hong Kong and Singapore. Now say hello to Malaysia. With its first-rate roads and telecommunications system, its well-educated workforce (many speak English), Malaysia is booming. Thirteen American semiconductor companies exported \$6.5 billion in electronic equipment last year out of Malaysia. And applications are piling up from sundry companies to locate within the latest Tiger.

The US's negative trade balance is building up hoards of dollars overseas. Those dollars come back in the form of stock and bond purchases plus outright takeovers of US corporations. On the face of it, this creates jobs in the US. But the profits from those foreign-owned corporations are shipped overseas and the dollars come back in the form of additional purchases. It's a compounding process. More than one-third of all chemical workers in the US now work for foreign-owned companies. Four of the nation's 10 largest chemical companies are now foreign-owned. Forty percent of the tires made here are from foreign-owned companies. By 1990 10 percent of US auto production will be by Japanese companies. And how about these figures -- 8% of all workers in manufacturing companies now work for foreign firms. Foreign firms now control 12% of all US-based manufacturing assets.

Are the Japanese buying up US businesses? Yes, but the British are actually doing more buying than the Japanese. Here are the 1988 figures for countries that invested most in US corporations: UK invested \$21.5 billion, Japan invested \$14.2 billion, Canada \$10.4 billion, Australia \$4.2 billion, France \$3.8 billion.

New York story: My sister, Kate, a New Yorker, is visiting us here in La Jolla. She told me that she drove to midtown Manhattan with a friend in her friend's big 500 SEL Mercedes. My sister suggested a garage for parking. Her friend is very thrifty, and spotting a rare parking place on Park Avenue and 64th street she parked her car (Park Avenue and 64th, by the way, is about as swanky a spot as you can find in New York). A few hours later my sister and her friend returned. The rear window of the Mercedes had been smashed out and the car's radio was gone (by the way, a Mercedes radio when removed from the car is useless, due to a safety device). Doormen had been standing literally within yards of the breaking, but "nobody saw anything." That's life today in the big city.

Crane's New York (an excellent magazine) just polled their readers on "What keeps us hooked on New York." The answers: 23.7% said the shopping; 23.7% said the cultural events; 22.5% said the sights; 12% said the entertainment; 5.2% said the sports.

More about my home town of New York. Felix Rohatyn, the investment banker who literally saved the City in the crisis of the late-1970s is predicting a worse crisis in the next five years. Says Rohatyn: "We are coming to the end of a decade of unparalleled economic boom in New York, and practically everywhere we look we find problems greater than they were 10 years ago. . . . The City's physical facilities are in disarray. Many of our bridges are crumbling or unsafe; many of our school buildings are a disgrace, and many of our streets would embarrass a Third World country.

Our public hospitals cannot keep up with the demands put on the system; our public schools cannot provide one of the most basic of civil rights -- a decent education -- and New Yorkers do not feel safe from crime anywhere in the City. And there is more talk today of people and businesses moving out of the city than I have heard in a decade." Rohatyn said that the crisis of the '70s was one of mismanagement. Today's crisis of homelessness, poverty, AIDS, and a stagnant local economy will be much more difficult to overcome.

US productivity still isn't picking up. The latest figures for the first quarter of 1989 show productivity dropping 1.1%. What's happening is that US firms are modernizing old plants, but they aren't putting money into new capacity. This is basically inflationary -- it means that the nation's ability to produce more goods isn't improving, and that means that as more dollars chase the same amount of goods, the prices of those goods go up.

Forget about the "big one" (the earthquake) that everybody's been predicting to hit California. In the current issue of *Manhattan* an article by Michael Lewis notes that huge earthquakes have hit Tokyo roughly every 70 years -- 1633, 1703, 1782, 1853, 1923. The next one is slated soon if the series continues. The result, says Lewis, would be chaos on Wall Street and throughout the Western World. Why? Because the quake would cause massive damage to Tokyo, requiring hundreds of billions of dollars to repair. The irony: Tokyo would go on a massive rebuilding campaign. But the rebuilding would require Japan to sell billions of dollars of its foreign investments, thereby sending the markets of the world into a tailspin. (Note: two-thirds of all of Japan's businesses are located in Tokyo.)

The powerhouse of the new united Europe of 1992 will be the European Parliament, headquartered in the Palais de l'Europe in the French city of Strasbourg. The group (which includes hundreds of European lawmakers) meets once a month, and they will decide new laws for all of Europe (already they had announced that by 1990 a majority of EC entertainment must be produced in Europe. They have also banned \$100 million of hormone-treated US beef).

My little guy, Ryan, plays Little League baseball for the Dow Theory Letters team (no kidding, that's the name). Up to now I had no idea how big the League is. Get this -- Little League is played in 33 nations. There are 140,000 teams with a total of 2.5 million players. I mean, that's a league.

Back to debt: The addition of Social Security surpluses to the annual US deficit provides us with a phoney figure, a figure that makes the deficit look better than it is. But the real debt additions can be seen by examining the year-to-year additions to the national debt. Last year the increase in the debt was \$250 billion. Now, a bit more than halfway through the fiscal year, the addition to the federal debt has already increased by \$175 billion. Talk about compounding!

I'm thinking more and more that housing and housing prices are the key to this nation's future, economically. Ever since WW II the ever-rising price of homes (with a few spates of occasional weakness) has been the "upward floater" that has made Americans feel wealthier. No question, the average citizens' savings and wealth is tied up in house. If or when we suffer a true depression in this nation, it will be (in my opinion) accompanied by, or even set off by, a drastic decline in home prices.

In NYC, due to the 1987 crash and the subsequent recession on Wall Street, housing and condo prices are now soft. The average price of a single family home in the New York area is down over last year. The high-priced restaurant business is also hurting. Some major projects are being put on hold. And job growth has flattened out. Barry Wine, who owns the high-priced Quilted Giraffe restaurant in NYC, offers two theories on why the restaurant business is slow: "One is that customers are so rich they've hired a private chef or have flown off to Paris for dinner; the other is that they can't afford it any more." Russell guess: some of each.

Speaking of housing, my good friend, Jon Strebler of Dean Witter Reynolds is doing a paper (for his M.A.) on the history of San

Diego single-family home prices. The results of his research shocked both Jon and me. Here is what he found. There have been five major rises in SD real estate prices since 1867. Four saw prices rise near or above 1000%. Each of the over-1000% rises saw a correction in which home prices dropped 50% or more! Here's the record.

1867-1873	+ 1,000%	1873-1877	- 84%
1877-1888	+ 1,500%	1888-1895	-79%
1895-1913	+ 960%	1913-1917	-46%
1917-1926	+ 190%	1926-1934	-57%
1963-1989	+ 970%		?

Writes Jon: "The extent of the current run is unprecedented, probably a direct result of the unprecedented debt proliferation during the same period." How will it all end? Mmmm, maybe this time it will be different.

Bill Holland, our local broker-radio commentator, notes that the Saudis recently announced a huge oil discovery that literally doubles their oil reserves to 315 billion barrels. In contrast, the US's "big" Alaskan oil field discovery 10 years ago amounted to 10 billion barrels. The US now owns a minuscule 3.7% of the world's oil reserves. That's worth pondering, isn't it?

One of the most annoying (call it flagrant) financial items is the advertising of new mutual and money funds which "waive the management fees." These funds boast of fat yields. So the fund draws in a hoard of money, and then it slaps on a management fee (which, of course, lowers the yield on all that "captured" money). Funds that are currently waiving their fee: Dreyfus Worldwide, Fidelity Spartan, Alger, Evergreen.

GOLD: I have a few pre-conditions for gold prior to a big gold move or a gold bull market. First, you have to have a situation where everyone is bearish, noncommittal or preferably where people actually hate the metal. Recently, I've read treatise after treatise on why gold is through, why people will buy currencies instead of gold if panic conditions prevail, why gold is headed for 250 or 200. That's the kind of sentiment I would want for a real bottom in gold. On a sentiment basis, gold could be at or near a bottom. The amount of black pessimism is about right.

Next, I want my ratio of gold divided by the NYSE Composite to turn up on a trend basis. The real moves in gold are always accompanied by a major rise in that ratio. In other words, during a gold bull market, gold (on a relative strength basis) acts better than common stocks on a trend basis. My gold/common stock ratio hit a low of 200 on June 1. That's about where the ratio is now. Nothing to cheer about here.

Next, I like gold to start moving up amid a good deal of skepticism. I don't want everyone recommending it, and I don't want all the advisory services jumping on the band wagon. That kind of action has not appeared yet. Gold was erratic, jumping 12 dollars one day and dropping 16 dollars on June 9; that's the kind of action calculated to keep most people out of gold. And it's calculated to keep those holding gold on the edge of their seats.

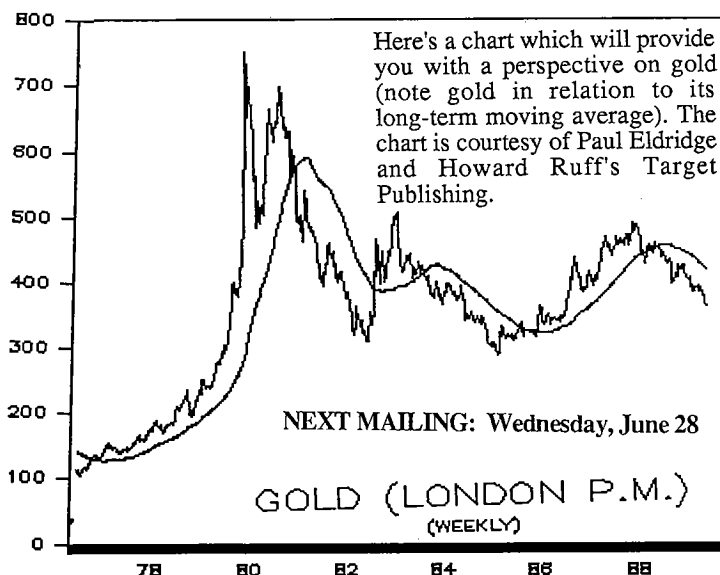
I continue to tell subscribers that we don't buy gold as an investment or as a trading vehicle. We buy and hold gold because it is part of a diversification program. Gold is the money that you own but don't worry about. The dollar can go to hell, the yen can collapse, the pound can become worthless, but gold will remain real money.

We're in an era of massive and compounding debt. And these are good times. If the world sinks into recession, the central banks will almost surely "print" oceans of fiat money in an effort to turn things around. At that time, it is possible that all paper money will be depreciated. But gold isn't paper money. So ironically, it is during deflationary, recessionary times that the price of gold may surge.

We are now enjoying our seventh year of good times. Some economists are saying publically that we have found a way to eliminate recessions and depressions. Let's hope they are right. But every year of happy times that goes by brings us closer to the test. The test, of course, is whether the world can produce another year of prosperity without a correction.

Meanwhile, gold has turned volatile. If you are buying gold coins on a monthly fixed-dollar basis you are ignoring price fluctuations and simply putting the coins away. In due time, paper money will have its problems and gold will have its day. Looking at the market action now, that doesn't seem possible. But it will happen as sure as night follows day.

I thought these words on gold from my old pal of 28 years, Harry Schultz, in his latest report were worth repeating (and I agree with Sir Harry): The current action "is part of what I referred to months ago as a massive eight year head-and-shoulders reversal pattern from 1981. Someday that base will launch gold up to \$1200 and beyond, but that day is somewhere ahead. I don't know how long this base building will take (I wish it would hurry) but it's not next week. With a recession around the corner, the US dollar is powering up, interest rates are high, gold is out of favor. Those who know gold is the only true money will accumulate it (no margin) during this 'unwanted' period, mentally prepared for lower prices and glad to see them in order to get more gold with fewer paper notes. Next year, recession will prod governments to print more money, which will push gold to \$400 plus. Patience is required for gold, but it will be rewarded in time." (FERC, PO Box 622 CH-1001 Lausanne, Switzerland.)



LATE NOTES: Despite lower US interest rates, the dollar surged early this week. That gave all the markets pause (they call it "food for thought"). A rising dollar means US goods are becoming less and less of a bargain for foreign buyers -- and that means lower profits for major US corporations (many of whom derive a large part of their profits from exports).

But what interests me more is the technical action of the stock market. I think the most important item is this: can the D-J Transportation Average better its recent high of 1165.59? If it can, all is well. If it can't, the technical picture starts to dim. Also, keep your eye on the recent Dow high of 2517.83. If the Dow rallies above that high with the Transports failing to better 1165.59, the existing divergence simply extends and becomes more flagrant.

June 2 DJIA 2517.83; PTI 3070; A-D Ratio -7.46
 June 9 DJIA 2513.42; PTI 3086; A-D Ratio -7.13
 Current Dow Yield: 3.52%; Dow P/E: 11.1
 Dow Book Value: 1009; Dow 200-day MA: 2225
 DowPow: 1004
 Percentage of Undervalued Blue-Chips: 17%